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UNCLAS SECTION 01 OF 02 LILONGWE 000294

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SUBJECT: MALAWI TOBACCO MARKET RELAXES

REF: LILONGWE 275

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SUMMARY

¶1. (U) Malawi's tobacco market has started to work again, after being disrupted by the GOM's new minimum price scheme. Buyers and sellers both seem to want to return to demand-driven pricing, but the market appears to be dealing with the government's prices for the moment. Buyers predict more problems later in the season, as higher grades of tobacco come to market. The net effect of Mutharika's price scheme may be to lower the price fetched by low-grade tobacco as buyers try to average out the higher prices paid for middle grades. End summary.

A WOBBLY AUCTION AND PROTESTING FARMERS

¶2. (U) After President Bingu wa Mutharika's March 27 announcement of government-mandated minimum tobacco prices (reftel), the tobacco auction has experienced an unusually sharp opening wobble. Selling appeared to be proceeding along more or less normal lines on opening day, although the lowest grade of tobacco--representing the largest volume in this market--went largely unsold at the new \$1.10/kg minimum price. This caused little upset among the growers at first, because they did not realize that their bales were not sold. When it became clear the next day that many of the day's sales were not sales after all, the growers asked for a stop to trading.

¶3. (SBU) A fresh round of negotiations between growers, exporters, and the government finally produced an understanding that allowed the auction to proceed on March 30. Industry sources have told us the principal pressure during these negotiations came from growers, who wanted to

sell quickly at whatever price the market would pay, never mind the new minimums. While the GOM has not conceded to adjust its minimum prices, it has made clear that tobacco classified as damaged or moldy can sell at whatever buyers want to pay for it. (At the start of the season, much of the tobacco does fit this description; quality improves during the course of the five-month selling season and drops again toward the end.)

A TEMPORARY PEACE

¶4. (SBU) A visit by Embassy staff to the auction floor confirmed that order had been restored, though the auction was not operating as efficiently as normal. Several traders told us that the new price scheme was still causing confusion, and there seemed to be a consensus among buyers and sellers that eventually things would have to return to demand-driven pricing. Around half the tobacco on the floor appeared to have been classified as moldy, though we saw plenty of higher-grade burley selling for good prices.

¶5. (SBU) As long as the market is dealing mostly in substandard tobacco, everyone is happy. The problems, we are told, will come later, as better grades make up more and more of the trading. So far, the higher-grade price floors have not been greatly tested against market demand. If those prices prove too high, either government will have to give or growers will pressure graders to give their tobacco a lower grade--a perverse but very real opportunity for graft. Government is not thought likely to follow through on its threat to export the tobacco itself if no one buys at the minimum prices or above. (On the other hand, the parastatal operator of the auction floor recently launched a buying/exporting company, Malawi Leaf Ltd. It is not yet

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clear how the company is being financed, and other exporters are wary of the possibility of anti-competitive behavior between the state, the auction operator, and the new company.)

COMMENT: ANOTHER BACKFIRED POLICY OF INTERVENTION

¶6. (SBU) COMMENT: Though the situation has calmed for now, it is bound to flare up again. It appears that buyers may low-ball the substandard tobacco in an effort to compensate for higher prices in the middle grades. This will do precisely the opposite of what Mutharika intended with his prices: poor, low-volume, low-quality producers will get artificially low prices. He may yet have to pay a political price for raising expectations and failing to deliver. In any case, this episode demonstrates once again Mutharika's instinct to interfere with markets to produce a social-welfare benefit; the same behavior has kept Malawi's fertilizer and maize markets out of balance and underdeveloped.

GILMOUR